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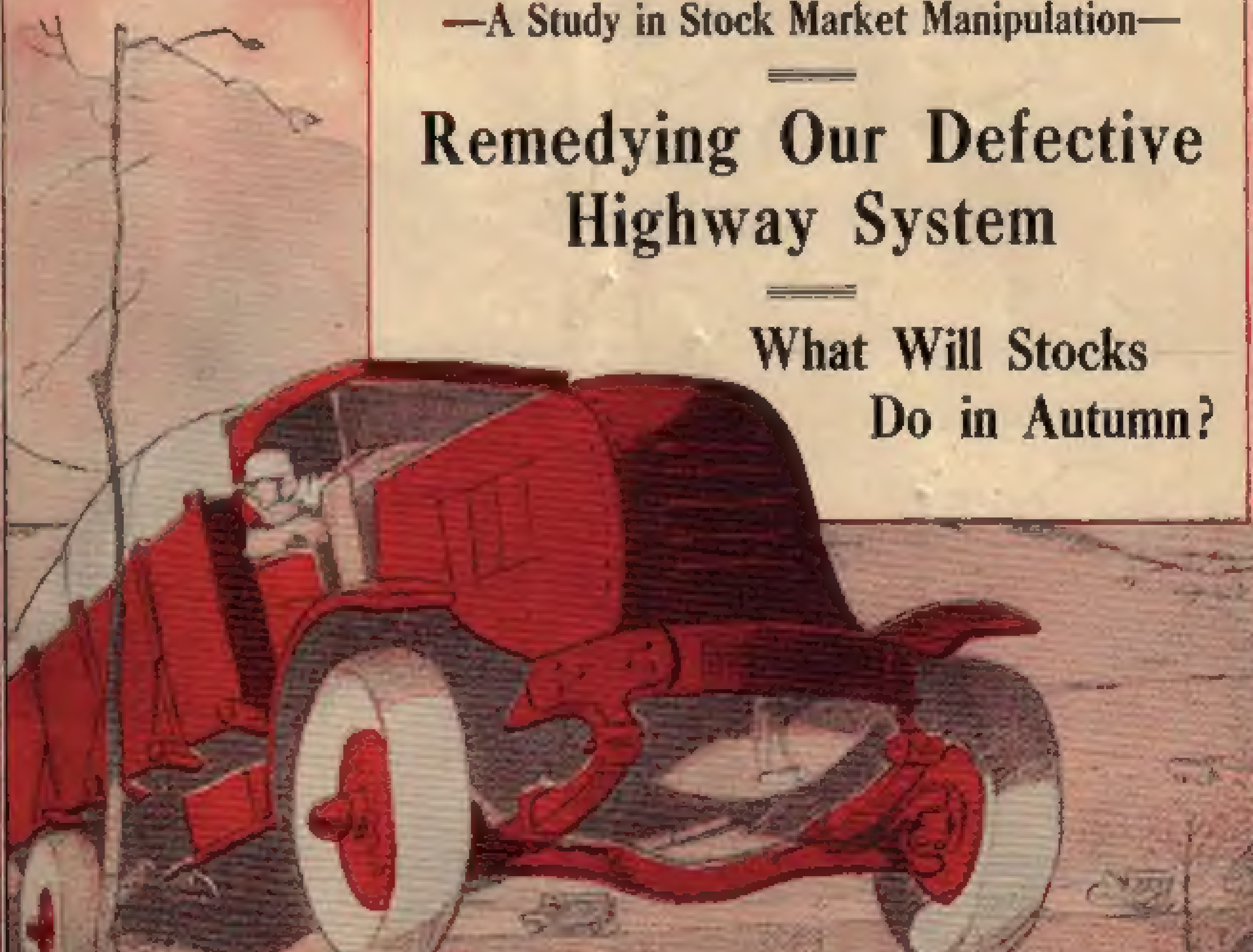
The Insiders—The Pools—and The Public

—A Study in Stock Market Manipulation—

Remedying Our Defective Highway System

What Will Stocks Do in Autumn?



The Insiders—The Pools—and The Public

How Manipulation by "Inside" Pools Operates to the Disadvantage of Investors

BY RICHARD D. WYCKOFF

IF a Wall Street Bible were to be arranged, it would probably contain "The Book of Daniel Drew," by Bouck White. In Chapter XVI of this interesting slice of Wall Street history we find the following, by Daniel himself:

"It is always an advantage in Wall Street operations to be on the inside of a railroad or a big industrial concern. You know, then, the monthly earnings before they are given out to the public. You get earliest notice of any favorable or unfavorable happening. You have access to the transfer books and know where all the circulating stock is. Any dangers that have arisen to the road's property, or any new connection favorable to the road's earnings capacity, is known to you long before the outside investors have got the tip. So that you can go onto the Stock Exchange and specklate in those shares with your eyes open, whilst the rest of the specklators are going it blind. An insider's position is as good as money in the chest.

"Besides, I had now another advantage as well. Not only could I predict well-nigh every turn in Erie shares. I could do even better. I could make it turn in either direction I choose. I had the horse by the halter, so to speak, and could lead him where I wanted. If my operations on the Stock Exchange made it needful for the stock to go up, I could give out that the road was prosperous—and her stock would go up. Or if I was in a bearish temper and wanted her shares to slump, I could make the road unprosperous for a time, and then stocks would go down to the point where I wanted them."

The interesting episodes described in the accompanying box occurred some sixty-odd years ago, and it would not be fair to say that Daniel Drew's methods are being duplicated in Wall Street today. But let us go back twenty-five years, when John W. Gates and his associates were manipulating the stock of the American Steel & Wire Co., which they had recently formed. A friend of mine met this crowd in the Waldorf one evening, and said, "Hello, Mr. Gates! How's your Steel & Wire Co. getting on?"

"Not so well, not so well," said Gates. "We've just closed the plant."

"Why is that," inquired my friend; "business falling off?"

"Oh, no," promptly responded Gates. "We're all short of the stock."

Many stock market happenings, involving the rawest kind of manipulation, have marked the intervening years. For example, a certain oil magnate of doubtful reputation created a company characterized by a prodigious number of shares. Whether he really thought he had a genuine oil company which would eventually justify their artificial market price of the stock, I cannot swear; but the gentleman's past record indicated that he was merely looking for suckers. He hired a prominent stock market operator, saying to him: "Sell these for me." And the operator did. The latter's profit was some two million dollars. How much the promoter realized, I leave to your guess. The receivers have not yet been able to get the company on its feet.

The controlling interest in a certain low priced railroad stock a few years ago saw a terrific slump coming in the market. What did they do? Go out and sell? No, that might have resulted in falling quotations and scaring off buyers. They too brought in a hired man and he organized a pool based on the false premises that this stock at its present market price was a great bargain and that if a lot of it could be corralled there should be about 50% profit in it. I am giving this manipulator credit for not knowing any better. Had he taken precaution to learn the relative value of this railroad stock compared with some others selling at lower prices, earning more money per share and far more attractive from every standpoint, he might not have organized the pool. But let us say he honestly believed the possibilities were liberal in proportion to the market price and that he sincerely believed he could show the pool a profit. His reward was to be a share of the profits without any risk.

Well, as soon as he got his people all lined up and he had buying power enough for a round lot of shares, he proceeded to acquire them. He gathered them all in within a very narrow range. This alone should have made him suspicious; but it seems that it did not. Strength in the market later enabled him to unload, with a 25% profit. He waited for a reaction and bought the whole line back. Then came the anticipated slump and members of the pool were asked to take up their pro rata share of the long stock, which was then selling at almost half what had been originally paid for it. The resulting loss of several hundred thousands, when divided among a number, was not so much per man on the average. The interesting part of the event was that both the manipulator and his followers had merely been used by the insider to take off his hands a round lot of stock which could not very well have been sold out in the market. When the pool had acquired all of its original stock the insider was out of all of his. Thereafter the proceeding did not interest the insider until the smash came, when possibly he picked up, at a shrinkage of one-half, what he had formerly sold out.

There is nothing new in all this. Manipulation began long before the days of Daniel Drew, temporarily an actor in the continuous performance, and it has proceeded merrily ever since. It has differed in detail but not in principle. On today's ticker tape there are hundreds of footmarks of pools,

THIS publication takes the position that manipulation of a company's securities by its officials is indefensible from an ethical viewpoint, and that it is poor business all around. In order to go more fully into this subject, we intend to print a series of articles giving current instances of this type of manipulation. We invite inquiries on the subject from our readers. If they believe their securities are being unduly influenced by the officials of their company, let them write to us. If warranted by the facts, we shall give the fullest publicity to these situations.

How a Famous Speculator Manipulated Erie Shares

Chap. XVI, "Book of Daniel Drew," by Bouck White

"I worked it something like this: Erie shares would be selling say at ninety. I would give orders to my broker to sell Erie heavily short. By selling short, a Wall Street operator puts out contracts to deliver the stock, say sixty days from that date, at present prices. If within those sixty days the price goes down, he can buy at the lower price and collect at the higher price named in the contract. Well, after I had got my short contracts placed, the other fellows, of course, taking my offers, because they figured that the shares were likely to go up rather than down, I would give out a statement to the effect that I, as owner of the chattel mortgages on the road, was about to foreclose. Or I would have one of my underfellows get out an injunction forbidding the road to pay any more dividends; or I would start a rumor that the road was going to rack and ruin. Immediately there would be a panic in Erie quotations. Her shares would slump; and before the sixty days were up, that former price of ninety would have shrunk to, say, sixty-five. So that now I would buy my shares at sixty-five, sell them for that contract figure, ninety, and thus pocket $25 clean profit on every share dealt in. If this particular deal had amounted to fifteen or twenty thousand shares, and I cleaned up $25 on every share, any one can see what a fine little sum it would amount to.

"Thereupon I would turn round and work it the other way. I was now short of the stock—that is, was sold out. I would therefore buy large blocks of it at the low figure of $65 a share. Now it stands me in hand to have the stock go up in value. So I give out a statement to the effect that my little difficulty with the road, which had been noised abroad some weeks before, has been settled; I have decided not to foreclose my chattel mortgage after all—the road has found a way to fix up the matter with me, is very prosperous, in fact is likely to declare a big dividend shortly. Immediately, with these refreshing rumors spreading abroad, Erie stock begins to go up. By and by she touches again the top-notch figure, say, ninety. Now I sell, and this way clean up $25 more on every share of stock I had dealt in.

"This is the advantage of operating from the inside. You win both going and coming. When a stock is going down you are a Bear, and make money by its fall. When the stock is going up, you are a Bull, and make money by the rise. In fact, I worked this so prosperous, that after a while they made it into a kind of proverb. It got to be a saying around the street: 'Daniel says up—Erie goes up. Daniel says down—Erie goes down. Daniel says wiggle-waggle—it bobs both ways'!"

manipulators, insiders and victims, but unless you are adept you cannot readily recognize these; to the uninformed, everybody's stock looks alike on the tape. That hundred shares of XYZ that just came from under the wheel, may have belonged to a widow or orphan; it may represent part of a 100,000 share lot being liquidated by the astute president of the corporation. To say that no one knows, would scarcely be correct. A few people know what and when he is doing anything, but as a rule it is carefully covered.

As Daniel Drew said: "An insider's position is as good as money in the chest." For Wall Street to say that this is "characteristic" and "to be expected," and to mention other familiar phrases from the catalogue of excuses, is to give manipulation the same dignity as bootlegging, but that does not make either bootlegging or manipulation legal, ethical or justifiable.

Let us consider some of the minor phases of manipulation: The stock of a certain company is lying dead around 40. Average transactions are 200 or 300 shares a day. Price range, a point from high to low, within a period of a week. Then follows a week or two of quiet picking up of the shares, which, towards the end of the fortnight, results in a price of around 45. There has been no excitement; few people have observed the signs of strength in the stock and although transactions have averaged 2,000 or 3,000 shares a day they have been so scattered as not to attract any attention. Suddenly the trading begins to get very lively. Ten to fifteen thousand shares a day are traded in, within a range from 45 to 46¾. Next day 48½ is recorded, and the following day on trading of 35,000 shares, the stock ranges from 49 to 50. Thus the market value of that company's shares has increased 25% without any information being given to the public as to what it is all about. Stockholders have not been notified of any change in earnings, outlook or financial position. The rise is a mystery— except to a very few insiders. After the close that evening, the company issues a very excellent six-months' statement which appears in the following day's newspapers, newstickers and slips. The president indicates that the executive committee will meet some time during the week and that possibly the stock may be placed on a 4% dividend basis; that further increases may be in order if earnings continue at the present rate, viz, over 10% on the common shares.

Being thus appraised of these developments some of the stockholders who paid 40 for their shares and who have taken a one or two point profit, proceed to buy back their stock. The public regards these shares as rather attractive. A lot of gossip gets into the newspapers. The matter is discussed in brokerage offices, and when a few days later the directors actually declare a 1% quarterly dividend and the stock rises to 52, everybody feels happy—except the former holders who, in their ignorance of what was going on, sold out in the low 40's.

Now I am taking you into the kitchen and showing you how the meal is cooked when I say that of course the quiet buying from 40 to 45 was inside-pool buying. Whether it included the chairman of the board, or the treasurer, or a few of the large stockholders who were "very close" is a mere detail. The point is that certain group of those in the management or allied thereto took advantage of their advance knowledge of the situation to buy all the stock that could be found around the 40-45 range, to say nothing of additional shares from 45 to 49, with the result that when the announcement was made and the former stockholders began repurchasing, and the public commenced buying, those insiders were there with the shares to supply that demand. In other words, insiders made a profit by selling to outsiders who did not buy at 40 but at 52.

Wall Street has been doing that sort of thing so long that it is regarded as "the regular thing"—like the host who mixes a cocktail before dinner. He and his guests may explain that they are protesting against an infringement on what they regard as their Constitutional rights. But in the case of the insider there is no such supposed justification, any more than there was for the robber barons who used to descend upon travelers along the Rhine.

In so stating I am making myself

very unpopular with a lot of shrewd people, who have been feeding at this trough for a long time, but in the interests of the largest aggregation of investors who have ever given their combined support to an American financial publication, I am asking Wall Street to give the public a square deal.

No one can deny that the deal is not a square one when the cards are stacked and marked. When an insider himself, or through the organization of a pool, directly or indirectly participates in the manipulation of a stock, he is stacking the cards against the public.

As I understand it, stockholders are partners. They do not elect the directors every year, but only when a company is first organized. After that the directors are a sort of self-perpetuating board in whose hands the management of the company rests. One would think from the way some directors carry on stock market operations that upon acceptance of this office they adopt the following resolution: "Having been elected a director, I will use my best efforts, not only in the management of this company's affairs to the end that its financial position may be strong, its earnings stable and its future prospects amply secured, but I will make sure that through my inside knowledge I personally benefit to the very limit. I will see that the auditor's advance estimate of earnings reaches my desk before any others, if possible. I will keep in close touch with all the other directors and officers, to say nothing of the sales department. Thus, when any improvement in earnings is in sight, I will be able to get my stock before the others begin to buy, and will have the delectable privilege of disposing of my shares whenever I think they are either high enough or the general public, including some of my stockholder partners, become too enthusiastic over its future. While my fee for attending directors' meetings is merely nominal, I can see where a very considerable amount of money can be made by me each year, anticipating the movements of the stock on the Exchange. Confidentially, instead of accepting these fees, I might well afford to compensate the company for letting me sit on the Board of Directors."

In certain respects Wall Street management of corporate affairs has shown a marked advance in the past twenty-five years. It might even be said that the Street has started to get rid of this sort of thing, but cannot greater progress be made? At present one of the chief complaints against insiders is that they are too fond of keeping their mouths shut; that even though they do issue quarterly statements, many things can and do happen over night. If stockholders are partners, why not treat them as such? Why not keep them advised by means of monthly reports mailed to every one of them. The expense would be trifling; the benefits would obviously be inestimable.

Officials Should Deny Printed Lies

When a Wall Street pool unwarrantably marks up the price of a stock 25% over its estimated value, why don't some of the company's officials deny the lies that are being printed, and do it promptly? To delay until the stock is marked up and distributed to the gullible, is merely to arouse a suspicion that the insider is one of the gang.

With all the thousand stocks listed on the Exchange, are there not some that afford opportunities for money making without resorting to the practice of deception of one's fellow stockholders?

By this I do not mean that all Wall Street corporations are run by their respective sets of manipulators, for such a statement would be far from the truth. Nor can I be expected to say just which one does and which one does not. There are numerous examples of concerns in which the insiders pay practically no attention to the stock market and who never furnish the basis for nor take any part in pool operations. But then there are others who must be regarded as different; who print just as few reports and give out just as little information as they possibly can; who, either for themselves, or for a coterie whom they hire or participate with, juggle their stocks in the market to an extent which is open to severe criticism.

The New York Stock Exchange is prompt to take action upon any case of manipulation brought to its attention, but as we all know, it is even more difficult to eliminate manipulation than bootlegging, nevertheless I thoroughly believe that Wall Street will some day wake up to the fact that in its own best interest manipulation, pool operations, and the old game of the insider against the outsider, will become obsolete; for although there may be a lot of money in skinning the public (it is nothing else), it will be a better Wall Street and a safer place for the speculative and investment money of the country when it has been purged of these highly questionable practices.

The "Insider" at Work